No. 11796

In the United States Circuit Court of Appeals for the Ninth Circuit

Central Investment Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.
SEWALL KEY,
A. F. PRESCOTT,
IRVING I. AXELRAD,
Special Assistants to the Attorney General.

INDEX

CITATIONS

779450—48——1

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11796

Central Investment Corporation, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 46–59) are reported in 9 T. C. 128.

JURISDICTION

This petition for review (R. 75–79) involves a deficiency in federal excess profits tax for the calendar year 1943 in the amount of $34,971.23 (R. 60). On March 21, 1945, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency in tax and statement. (R. 8–13.) Within ninety days thereafter and on May 8, 1945, the taxpayer filed a petition (R. 3–8) with the Tax Court of the United States for redetermination of the deficiency in tax under the

provisions of Section 272 of the Internal Revenue Code. The decision of the Tax Court sustaining the deficiency in tax was entered on July 31, 1947. (R. 60.) The proceeding is brought to this Court by a petition for review filed October 30, 1947 (R. 75–79), pursuant to the provisions of Sections 1141–1142 of the Internal Revenue Code.

QUESTION PRESENTED

Did the Tax Court err in holding that a California franchise tax imposed and paid in 1944 for the privilege of doing business for the year 1944 but measured by income realized in 1943 is not accruable and deductible for federal tax purposes in the year 1943, under Section 23 (c) (1) of the Internal Revenue Code, in the case of a taxpayer on the calendar year and accrual basis of accounting?

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations involved are set out in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court may be summarized as follows:

The taxpayer is a California corporation, organized October 6, 1921, with its principal offices located in Los Angeles, where it owns the Biltmore Hotel. At no time material hereto did the taxpayer have any pending negotiations for the possible sale of its Biltmore Hotel property or contemplate dissolution or liquidation. (R. 47.)

In 1929 the California Legislature enacted the Bank and Corporation Franchise Tax Act, chapter 13, Laws of 1929, hereinafter referred to as the Act. The Act, as amended in 1943 in Section 4 (3), provides that corporations doing business in California and not otherwise exempt "shall annually pay to the State, for the privilege of exercising its corporate franchises * * *, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year." (R. 47–48.)

Section 11 provides that the term "income year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed. The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. A "taxable year" may constitute a period of 12 months or of less duration. (R. 48.)

Section 4 (7) provides that taxes under this section and under Sections 1 and 2 of this Act shall accrue on the last day of the income year as defined in Section 11. (R. 48.)

Section 29 (a) provides that the taxes imposed shall constitute a lien upon the real property of the taxpayer and shall attach on the last day of the income year. (R. 49.)

Prior to the 1943 amendment of the Act, it provided that the tax accrued and the lien therefor attached on the first day of the taxable year. (R. 49.)

Section 13 of the Act requires every corporation subject to the tax to file a return within two months and 15 days after the close of its income year. The tax is payable on or before the fifteenth day of the third month following the close of the ninth month following the close of the income year. (R. 49.)

Section 13 of the Act also deals with the computation of the franchise tax in situations where corporations are commencing business in their first taxable year or are withdrawn or dissolved within the taxable year. In the case of commencing corporations it is provided in general that the tax for the first taxable year shall be based on the income of such year and paid during the second year. With respect to corporations withdrawing or dissolving during the taxable year it is provided in general that the tax for such taxable year be reduced on account of the portion of such year during which the taxpayer does not do business in California. (R. 50.)

For the privilege of doing business within the State during the calendar year 1943, the taxpayer filed on April 26, 1943, its franchise tax return which disclosed its gross and net incomes for the calendar year 1942 and a franchise tax liability of $19,736.60, which was paid in April and September, 1943. (R. 50.)

For the privilege of doing business within the State during the calendar year 1944, the taxpayer filed on May 5, 1944, its franchise tax return which disclosed its gross and net incomes for the calendar year 1943 and a franchise tax liability of $43,174.36. (R. 50–51.)

The franchise tax for 1944 was imposed by Section 4 (3) of the Act and was determined "according to or measured by" the net income for the calendar year 1943 of $1,206,923.17. The tax of $43,174.36 was set up on the taxpayer's books of account as a liability as of December 31, 1943, before the closing of the books for the calendar year 1943. It was paid in March and September, 1944. The taxpayer has never disputed its liability for the whole or any part of the tax, has never filed any claim for refund or credit for the whole or any part thereof, and has never had, and does not now have, any intention of filing any such claim. (R. 51.)

In filing its federal income and excess profits tax returns for the calendar year 1943, the taxpayer claimed deductions not only for the California franchise tax imposed for the privilege of doing business in the State during 1943, in the amount of $19,736.60, but also for the California franchise tax imposed for the privilege of doing business in the State during 1944, in the amount of $43,174.36. (R. 51.)

The Commissioner disallowed the deduction of $43,174.36 for the calendar year 1943 on the ground that the franchise tax paid for the year 1944 was properly accruable and deductible for federal income tax purposes in the calendar year 1944 under Section 23 (c) of the Internal Revenue Code. (R. 51–52.)

The Tax Court sustained that action. (R. 46.) The taxpayer petitions for review. (R. 75.)

SUMMARY OF ARGUMENT

The purpose of accrual accounting in federal income tax law is to accurately relate the expense of doing business to the income it produces in order to determine net income, the base of the tax. It is now settled beyond dispute that this consideration tested by whether all events have occurred fixing the fact and amount of liability is the standard marking the year for accrual and deduction of state taxes. The Commissioner and the Tax Court, therefore, correctly determined that the 1944 California franchise tax undisputedly imposed on the taxpayer for the privilege of doing business in 1944, and returned, assessed, and paid in 1944, was not a proper accrual for 1943.

Taxpayer seeks to deduct both the 1943 and 1944 California taxes in 1943 because of a 1943 change in the California statute providing that a lien exists and the tax accrues for 1944 taxes on December 31, 1943. But in providing a lien for a nonexistent liability the legislature may have acted contrary to the California Constitution. In any exent, the enactment did not change the undisputed fact that until taxpayer did business in 1944 there was no liability for the tax. It is impossible, then, to conclude that all, or even any, of the events fixing liability occurred in 1943. And the major accrual premise that expenses creating income be related to the income they help to produce in order to accurately determine net income is completely ignored by taxpayer when it attempts to deduct the expense of 1944 business in 1943 and in addition seeks

to deduct the 1943 tax as well. The result is distortion of income for 1943 and later years as well.

Code Section 41 delegates unusual discretion to the Commissioner to determine when an accrual occurs measured by the standard of clearly reflecting income. The Commissioner has consistently related this and similar taxes to the year for which they were imposed and these rulings in view of Section 41 are entitled to more than usual weight.

Counsel's contention that the provision of California law accruing the 1944 tax in 1943 is dispositive of the accrual date for federal tax purposes directly contradicts a long line of authority that the revenue laws are to be given a uniform interpretation throughout the United States unless by their necessary implication they are made dependent on state law. Nothing in Sections 23 (c) (1) or 41 here involved requires resort to state law in the context of this controversy. Moreover, the Supreme Court has expressly held that when an item accrues is a federal, not a local, question.

Finally, although not necessary to a resolution of this issue on our analysis because the Tax Court could reach only the result it did, if the Court should think the issue susceptible of two solutions, the question is one governed by the *Dobson* principle. The issue is one of accounting referred to in the *Dobson* opinion itself as one of a type within the principle there announced. Moreover, the Court has expressly held, in a later decision, that the time for accrual of a state tax is governed by *Dobson*.

Thus, while the decision below is the only possible one on the merits in view of the controlling decisions of the courts, it is, in addition, entitled to finality on the alternative theories (1) that it approved the Commissioner's determination which is final barring abuse of discretion, and (2) that the Tax Court's decision is entitled to finality within the *Dobson* principle. Both of these approaches are aided by settled doctrine that a deduction provision is to be narrowly construed and interpreted to avoid a double deduction which in a real sense taxpayer here seeks.

ARGUMENT

The California franchise tax imposed and paid for the privilege of doing business during the calendar year 1944 was not an accruable deduction for Federal income tax purposes for the calendar year 1943

The sole question presented by this appeal is whether the Tax Court erred in sustaining the Commissioner's determination that taxpayer, which kept its books by calendar years on the accrual basis, could not accrue as a tax deduction for the year 1943, the 1944 California franchise tax expressly imposed for the privilege of doing business in 1944. The relevant provisions of the statute imposing that tax (California Bank and Corporation Franchise Tax Act) are contained in the Tax Court's findings of fact (R. 47–50), summarized in the statement, *supra,* and set forth in the Appendix, *infra.* In sum those provisions are that an annual tax is imposed on a calendar year taxpayer "for the privilege of exercising its corporate

franchises within this State," measured by its net income for the preceding calendar year;[1] a minimum tax of $25 is imposed;[2] the term "income year" is defined as the calendar year upon which net income is computed[3] and "taxable year" is the calendar year "for which the tax is payable;"[4] the tax "accrues" on the last day of the "income year"[5] and constitutes under some circumstances a lien on the last day of the "income year;" and in others on the date the franchise commissioner files with the county recorder a certificate stating that the tax has been demanded and not paid;[6] a return must in the case of calendar year taxpayers be filed on March 15 of the taxable year;[7] the tax must be paid in two installments on March 15 and September 15 also of the taxable year;[8] and, finally, a corporation which dissolves in the taxable year is only liable for that proportionate part of

---

[1] Section 4 (3), California Bank and Corporation Franchise Tax Act.

[2] Section 4 (5), California Bank and Corporation Franchise Tax Act.

[3] Section 11 (a), California Bank and Corporation Franchise Tax Act.

[4] Section 11 (b), California Bank and Corporation Franchise Tax Act.

[5] Section 4 (7), California Bank and Corporation Franchise Tax Act.

[6] Section 29, California Bank and Corporation Franchise Tax Act.

[7] Section 13, California Bank and Corporation Franchise Tax Act.

[8] Section 23, California Bank and Corporation Franchise Tax Act.

the tax as the number of months it exists in the taxable year bears to the entire income year.[9]

The present controversy results from the 1943 amendment to the Bank and Corporation Franchise Tax Act changing the "accrual" date from January 1 of the tax year to December 31 of the income year, and similarly providing that under some circumstances a lien arises on December 31 of the income year instead of January 1 of the tax year, the former provision. As a result of these changes and no others, taxpayer here contends that it is entitled to deduct both the 1943 tax based on 1942 income imposed by the statute prior to the 1943 amendment and the 1944 tax based on 1943 income.

This contention, we think it no overstatement to say, flies in the teeth of some of the most basic and well established principles in federal revenue law and is made in support of an avaricious tax objective that would in effect result in a double deduction for the war-tax year 1943[10] with its resultant understatement and distortion of income not only for 1943 but in some degree for subsequent years as well. The importance of this as a "test" case to the revenue and all corporate taxpayer corporations liable for a 1944 and later California franchise taxes is suggested in the

---

[9] Section 13 (k), California Bank and Corporation Franchise Tax Act.

[10] Cf. *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 68; *Burnet* v. *Aluminum Goods Co.*, 287 U. S. 544, 551; *Spokane Dry Goods Co.* v. *Commissioner*, 125 F. 2d 865, 867 (C. C. A. 9th); *Levi-Strauss Realty Co.* v. *United States*, 41 F. 2d 55 (C. C. A. 9th).

opening statement on behalf of the Commissioner (R. 20–21) and in taxpayer's motion for review by the entire Tax Court (R. 61–62).

A. The 1944 California franchise tax was not an accrued deduction in 1943 because it was neither (1) imposed for, and therefore not a cost of business in 1943, nor (2) did all, or even any, of the events creating liability for the tax occur in 1943

Code Section 23 (c) (1), Appendix, *infra,* provides a deduction from gross income for "Taxes paid or accrued within the taxable year." The taxpayer kept its books on the accrual basis by calendar years. (R. 52.) The 1944 California tax return was filed on May 5, 1944, and paid in two installments on March 13, 1944, and September 1, 1944. (R. 50–51.) There is, of course, no question that the deduction could not be taken in 1943 for "Taxes paid." And we think it is just as clear that no deduction could be taken in 1943 for the 1944 tax as "Taxes * * * accrued."

1. *The accrual doctrine in the Supreme Court and the Circuit Courts of Appeals*

The principles which govern deductions for accrued taxes are well established: (1) The obligation to pay the tax must have been "incurred" within the taxable year, i. e., the tax must be imposed for the taxable year in which the deduction is taken—it must be a cost of business of the taxable year; (2) all the events giving rise to and therefore creating a fixed and definite liability for payment must occur in the taxable year—a contingent liability will not suffice. *United States* v. *Anderson,* 269 U. S. 422; *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, 284, 286–

287; *Dixie Pine Co.* v. *Commissioner,* 320 U. S. 516, 519; *Aluminum Castings Co.* v. *Routzahn,* 282 U. S. 92, 99; *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357. Cf. *Lucas* v. *American Code Co.,* 280 U. S. 445; *Brown* v. *Helvering,* 291 U. S. 193; *American National Co.* v. *United States,* 274 U. S. 99, 103–105; *Fawcus Machine Co.* v. *United States,* 282 U. S. 375.[11] These and the decisions cited in the footnote are direct authority against taxpayer's position.

The undisputable and controlling facts in this controversy are that the 1944 tax was imposed for the privilege of doing business in 1944 (California Bank and Corporation Franchise Tax Act, Section 4, (3)) and taxpayer so concedes (R. 23) and that as of De-

[11] There is no more firmly established principle in tax law and accordingly there are numerous decisions of Circuit Courts of Appeals announcing and applying these rules. A representative group are *Lichtenberger-Ferguson Co.* v. *Welch*, 54 F. 2d 570 (C. C. A. 9th), and see particularly pp. 571–572; *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932, 938–939 (C. C. A. 9th); *Keller-Dorian Corp.* v. *Commissioner*, 153 F. 2d 1006 (C. C. A. 2d); *Van Norman Co.* v. *Welch*, 141 F. 2d 99, 103 (C. C. A. 1st); *George S. Colton Elastic Web Co.* v. *United States*, 116 F. 2d 202 (C. C. A. 1st); *Commissioner* v. *Schock, Gusmer & Co.*, 137 F. 2d 750 (C. C. A. 3d); *Citizens Hotel Co.* v. *Commissioner*, 127 F. 2d 229 (C. C. A. 5th); *Allen* v. *Atlanta Stove Works*, 138 F. 2d 452 (C. C. A. 5th); *Ed. Schuster & Co.* v. *Williams*, 283 Fed. 115 (C. C. A. 7th); *Art Metal Const. Co.* v. *United States*, 17 F. Supp. 854, 864 (C. Cls.); *Triplex Safety Glass Co. of North America* v. *Latchum*, 131 F. 2d 1023 (C. C. A. 3d); *London-Butte Gold M. Co.* v. *Commissioner*, 116 F. 2d 478 (C. C. A. 10th). See also Edelman, Time for Accrual & Deduction of Taxes, 23 Taxes, Tax Magazine 110 (1945), for a penetrating discussion of the law as it is and the author thinks it should be from both a legal and accounting viewpoint.

cember 31, 1943, there was no liability for the tax because if the taxpayer did no business in 1944 there would be no tax (R. 29). California Bank and Corporation Franchise Tax Act, Sections 4 (3), and (5), 11 (a) and (b), 13 (k). The conclusion is required by the controlling decisions of the Supreme Court and the Circuit Courts of Appeals that the 1944 tax could not be an accrued deduction for 1943.

The leading case is *United States* v. *Anderson, supra.* There the taxpayer had deducted in 1917 a munitions tax assessed and paid in 1917 but imposed on profits from the sale of munitions in 1916. The Court in sustaining the Commissioner's position that the deduction was improper in 1917 because it accrued in 1916 rejected taxpayer's accrual test characterized by the Court as a "technical legal sense" that a tax accrues when it has "been assessed and becomes due" (p. 441) for a pragmatic approach based on the purpose of the income tax law. The essence of the decision is that the accrual provisions, Sections 12 (a) and 13 (d) of the Revenue Act of 1916, c. 463, 39 Stat. 756, the forerunners of the Code provisions here involved, were designed to allow (p. 440)—

> taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period.

In applying this principle the Court observed that since taxpayer's (p. 440)—

> true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year,

it followed that the tax must have accrued in 1916. Recognizing that it might not always be so clear what is a cost of doing business attributable to a given year and in specifically rejecting the "technical legal" argument of taxpayer, the Court also held that a fixed liability for the tax was necessary to accrue it and that such a liability existed in 1916 and before the tax was due or assessed.

Because of the controlling effect of the *Anderson* case, apparently also recognized by taxpayer's counsel who refer to it extensively (Br. 29, 46, 47, 50, 51, 53), although ignoring the vast body of other relevant Supreme Court decisions other than *Security Mills* and *Dixie Pine, supra,* which they misconstrue, it is desirable in passing to call attention to their patently erroneous view of the case. They typically state, for example (Br. 29):

> If the taxing statute contains neither accrual nor lien date, then it is manifestly proper to determine when "liability" arises from all of the provisions of the statute, including a consideration of the nature and character of the tax and of the period *for* which the tax is imposed (*e. g., United States* v. *Anderson,* 269 U. S. 422 * * *).

We have just observed that *Anderson* makes the

controlling factor the relationship of the tax to the year for which it is imposed and secondly requires that there be a liability for the tax in the accrual year. The statement that these questions are important only when there is neither an "accrual nor lien date" is simply not true. The accrual and lien dates were apparently not even worthy of the "technical legal" characterization given to the assessment date in the *Anderson* opinion because there in fact existed a precisely defined statutory lien date for the munitions tax imposed by Title III of the Revenue Act of 1916 involved in *Anderson*. The opinion of the Court states the tax was due in 1917 (pp. 436, 441) and sections 304 and 305 of the Revenue Act of 1916 so provide. Section 3186 of the Revised Statutes as it then existed and had for more than fifty years prior thereto provided:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time it was due until paid, * * *

There is, therefore, no question that the Court in *Anderson* rejected the assessment date and ignored the lien date in favor of the date when there was liability for the tax and the year in which the tax was an expense of the business.

The 1944 California franchise tax is probably more clearly a cost of doing business attributable to the year for which imposed than any other kind of tax because it is, as we have observed, the payment to

the State for the privilege of doing business itself.[12] In addition, so far as the applicability of *United States* v. *Anderson* is concerned, there was no liability for the tax until business was done in 1944[13] and in fact the tax liability arose monthly at the rate of one-twelfth of the tax measured by 1943 income (Section 13 (k), California Bank and Corporation Franchise Tax Act R. 28–32), because there is no liability for one-twelfth of the tax for each month the corporation does not exercise its franchise.

Actually, then, this case is on "all fours" with *Anderson.* The only difference is that here taxpayer seeks to deduct the tax a year in advance of the year for which it was imposed and in which it first became a liability whereas in *Anderson* the taxpayer sought unsuccessfully to deduct the tax the year after the year for which it was imposed and first became a liability. The *Anderson* case has been cited with approval in every subsequent case involving accrued deductions. It is law today and dispositive of this case.

---

[12] The Supreme Court so characterized the California franchise tax in sustaining it against constitutional attack. *Pacific Co.* v. *Johnson*, 285 U. S. 480. And earlier in *Educational Films Corp.* v. *Ward*, 282 U. S. 379, 388, the Court stated in sustaining the similar New York franchise tax:

"If we look to the operation of the present statute, it is plain that it can have no application independent of the corporation's enjoyment of the privilege of exercising its franchise. If appellant had ceased to do business before November 1, 1929, it would not have been subject to any tax under this statute, although it had received, during its preceding fiscal year, income which the statute makes the measure of the tax. * * *"

[13] Cf. *Educational Films Corp.* v. *Ward*, fn. 12, *supra.*

These propositions were reaffirmed in the last accrual deduction cases considered by the Supreme Court. *Dixie Pine Co.* v. *Commissioner, supra; Security Mills Co.* v. *Commissioner, supra.* In *Dixie Pine* the Court held that taxpayer could not accrue in 1936 as a deduction a gasoline tax imposed on a solvent used in its 1936 business where it was contesting liability for the tax. The Court said (p. 519):

> It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact that the taxpayer's liability for items of indebtedness deducted though not paid; * * *

Citing *United States* v. *Anderson, supra.* Although the case is not directly in point because there is no contested liability, it is important to note than *Anderson* is expressly approved. The test of accruability reaffirmed in *Dixie Pine* requires an affirmance of the Tax Court because by no stretch of the imagination can it be said that "all the events" fixing "the amount and the fact of taxpayer's liability" occurred in 1943 in view of the incontroverted facts that the tax was imposed, returned, assessed, and paid in 1944. On the contrary, it is accurate to say that none of the events fixing liability occurred in 1943. *Security Mills* involved precisely the same question as *Dixie Pine* except that the tax was a contested processing tax rather than a State gasoline tax. The only discernible legal difference in the two cases was that in *Security Mills* the taxpayer relied on Section 43 of the

Revenue Act of 1934, c. 277, 48 Stat. 680, identical with Section 43 of the Code, Appendix, *infra*. That section provides that for taxpayers on the accrual basis, deductions shall be taken when accrued "unless in order to clearly reflect the income" they should be taken for a different period. Taxpayer, apparently conceding that the tax had not accrued in 1935, the tax year, claimed that it could nevertheless deduct it because under Section 43 an adjustment can be made whenever it is "unjust or unfair" not to. The Court rejected the argument limiting Section 43 because of its legislative history to instances of fixed liabilities payable in fixed installments over a series of years. The decision therefore does not support taxpayer's argument based on it (Br. 55) because absent the Section 43 argument, the case reaffirmed the *Dixie Pine* principle, in turn based on *United States* v. *Anderson,* that a tax accrues in the year when *all* the events occur fixing the fact and amount of liability.

Actually taxpayer's false reliance on *Security Mills* discloses that it is faced with a dilemma. Assuming *arguendo* that counsel are correct in their position that the liability for the 1944 tax arose in 1943 as well as the 1943 tax based on 1942 income, the "unless" clause of Section 43 of the Code as interpreted in *Security Mills* would permit the Commissioner to place the deduction in 1944 "in order to clearly reflect the income." For the change in the California law on taxpayer's view of this case created a liability in 1943 for the taxes of two years a situation not to be distinguished from liability for interest or rent for

a period of years—the example used in the committee reports when what is now Section 43 first came into the revenue laws by Section 200 (d) of the Revenue Act of 1924, c. 234, 43 Stat. 253. H. Rep. No. 179, 68th Cong., 1st Sess., pp. 10–11 (1939–1 Cum. Bull. (Part 2) 241, 249); S. Rep. No. 398, 68th Cong., 1st Sess., pp. 10–11 (1939–1 Cum. Bull. (Part 2) 266, 273).

But since taxpayer's basic contention is devoid of merit, the tax did not accrue in 1943 and we do not logically reach the "unless" clause of Section 43.

Counsel recognizing the importance of a fixed liability in the years of accrual emphasize that a lien arises on December 31, 1943, for the 1944 tax. Even if the California lien were one indicia of liability it is important to note that the cases require that *all* events which fix liability must have occurred. Taxpayer's emphasis on the lien date further ignores the whole purpose of the accrual system—i. e., to relate the expense of earning income to the income itself. Finally, the ultimate error in their lien date emphasis is that the lien is not even one indicia of liability. Counsel seem to argue that the State having created a lien it must have also created a liability. (Br. 12–19.) The whole structure of the state statute described at the outset of the argument contradicts this conclusion. On December 31, 1943, the taxpayer was not indebted by one cent to the State for 1944 franchise taxes. Nor could it be indebted for the full amount of the tax unless it did business from January 1, 1944, through December 16, 1944. (R. 28–29.) Section 13

(k), California Bank and Corporation Franchise Tax Act. It is perfectly clear then that there was no liability for the tax on the statutory lien date and under California law the purported lien without an obligation to support it is unconstitutional as a taking of property without due process of law. *East Bay Municipal U. Dist* v. *Garrison,* 191 Cal. 680, oddly enough cited by taxpayer (Br. 18); cf. *Dodge* v. *Nevada Nat. Bank,* 109 Fed. 726 (C. C. A. 9th). See also Traynor and Keesling, Bank and Corporation Franchise Tax Act, 23 Cal. L. Rev. 51, 73–75.

But even if the lien were valid it does not mark the accrual date under federal law because California often imposes liens for taxes before all the events occur which fix the fact and amount of liability—and the latter and not the lien dates, we again emphasize, are the tests of accrual. Thus, this Court gave priority in a bankruptcy proceeding to liens of California for taxes payable under the Oil and Gas Conservation Act, as well as to liens for franchise taxes and for Los Angeles County personal property taxes over a lien of the United States. *In re Knox-Powell-Stockton Co.,* 100 F. 2d 979.[14] And more recently, also in a bankruptcy proceeding, a California franchise tax lien (under the pre-1943 franchise tax

[14] Counsel's statement that (Br. 15) "Furthermore, the lien date in the *Knox-Powell-Stockton* case was prior to the period *for* which the tax was imposed" is incorrect. The opposite is true since the Court's opinion states that all three types of liens attached on the first Monday in March of the year for which the tax was imposed. But if counsel's statement was correct, it would only underline the irrelevancy of the lien date as a test of accrual.

amendments) prior in time, was given priority over the perfected lien of the United States. *United States* v. *Sampsell,* 153 F. 2d 731 (C. C. A. 9th). The Court in emphasizing that the liens were inchoate distinguished the cases arising under Section 3466 of the Revised Statutes (31 U. S. C. 1940 ed., Sec. 191). Examples arising under Section 3466 where liens of the United States were preferred over inchoate state liens are *United States* v. *Texas,* 314 U. S. 480, and *New York* v. *Maclay,* 288 U. S. 290. In those cases the Supreme Court gave preference to perfected liens of the United States over prior liens of the States characterized by the Court as "inchoate" because the claim was both unliquidated and uncertain.

The priority of lien cases, then, underline the irrelevancy of the lien date as determinative of the accrual of state taxes for income tax purposes because they establish that in some circumstances liens securing unliquidated and uncertain claims (such as would be California's claim for 1944 franchise taxes on December 31, 1943) might be recognized though no case has gone that far, and in others they are not, but, in any event, an item to be accrued must be a fixed liability and ascertainable in amount.

It is perfectly plain then, that counsel's advocacy of the lien date by which to fix the accrual is but a poorly disguised attack on the well settled principles of accrual.

2. *The Tax Court decisions do not support the taxpayer*

Counsel's approach to this case in general is to ignore the controlling decisions of the Supreme Court and the Circuit Courts of Appeals, with the exceptions which we have noted and others that have no bearing on the issue. This is perhaps understandable in view of the fact that they could find no support from those quarters. What is surprising is that they rely largely on decisions of the Tax Court. It is a complete answer to such an approach that in so far as the Tax Court's decisions are out of harmony with those of the Supreme Court and this and other Circuit Courts of Appeals, they are persuasive only of the wrong result and in so far as they differ from the decision below they must have been repudiated by the Tax Court itself in the decision from which this appeal was taken.

That the entire Tax Court is convinced of the correctness of the result below is evidenced by the fact that the presiding judge expressly refused to review the decision (R. 74) after taxpayer had filed a "Motion for Review" (R. 61–74) which included most of the objections to the decision which counsel make here. Moreover, a different Tax Court judge has reached the same result expressly on the authority of the decision below. *Grace Bros., Inc.* v. *Commissioner,* 10 T. C. No. 21. Still more important that decision was reviewed by the entire court and there were no dissents.

But in any event our reading of the Tax Court decisions cited by counsel shows no inconsistency with the

result here, but on the contrary in so far as relevant, support the decision below. The closest case is *Petaluma & Santa Rosa R. R. Co.* v. *Commissioner,* 11 B. T. A. 541, which involved the California public utility franchise tax. It was there held that it was improper to accrue the 1921 tax measured by 1920 income until 1921. The reason for that result is the same which we urge here that (pp. 546–547) "If the corporation did not own the franchises and other property in 1921, there was no liability for the tax for that year," and this notwithstanding (p. 547) "the measure existed [in 1920] by which it [the tax] could have been determined, if there was any liability."

Similarly, the other Tax Court cases relied on by counsel in so far as relevant are contrary to their position. For example, *Durst Productions Corp.* v. *Commissioner,* 8 T. C. 1326, where the Tax Court held that a corporation on the accrual basis, the fiscal year of which ended May 31, 1944, properly accrued for the year ending in 1944, the 1944 tax based on 1944 income. The significant factor in the decision is that it gave effect to the change in the New York Corporation Franchise Law measuring the tax by the income of the "privilege year," rather than the income of the preceding year as had been the case, and is now the case in California. The language which counsel quotes from the opinion that (Br. 51) "The tax being calculated on the amount of earnings for the year in issue its charge against those earnings seems to accord with the theory of accrual" is perfectly correct in the con-

text of that case because the tax and income years coincided. But it is not generally true that a tax is accrued for the year the earnings of which are the measure of the tax. *Petaluma & Santa Rosa R. R. Co.* v. *Commissioner, supra.* We do not understand counsel to contest this because if the law were otherwise taxpayer has incorrectly deducted his 1943 tax measured by 1942 income. Thus, while *Durst* is correct on its facts the language is too broad. This is the view expressed in Mayer, The Accrual Date of the New York State Franchise Tax, 26 Taxes, Tax Magazine 43 (1948), cited by counsel. (Br. 51.)[15] Neither the decision nor the article suggests that the "lien" date has any relevance in determining the accrual date. In any event, counsel grudgingly concedes as "true" (Br. 53) that an examination of Article 9-A of the New York Tax Law discloses that the 1944 tax lien arises in 1945. This was ignored by both litigants and the court as it was in *United States* v. *Anderson* and all other non-

[15] The article states (p. 47):

"Thus, it would seem that with respect to the New York State franchise tax levied under the old statute [e. g., like California's measured by income of the preceding year], the suggestion that it accrues in the measuring period (the court's alternative reason in the *Durst* case) fails to meet the accrual test both accounting-wise and tax-wise.

*   *   *   *   *

we shall find that the decision, in spite of its broad language, probably was not intended, and cannot be held, to apply to taxable years other than the one in issue and, in addition, to a few fiscal periods with respect to which the effect of local law is comparable."

real estate accrual cases [16] because it is patently an irrelevant consideration.

H. H. Brown Co. v. *Commissioner,* 8 B. T. A. 112, involved the Massachusetts excise tax measured by income of the tax year. The Board properly held the tax assessed as of April 1 of the tax year deductible for the fiscal year ended June 30, 1922. Thus, the tax was imposed for and became a liability for the year deducted which completely supports our position. For a more authoritative view of the accrual year of the Massachusetts excise tax reaching the same result see *George S. Colton Elastic Web Co.* v. *United States,* 116 F. 2d 202 (C. C. A. 1st). See also *Van Norman Co.* v. *Welch,* 141 F. 2d 99 (C. C. A. 1st).

The Federal capital stock accrual cases, such as *Atlantic Coast Line Railroad Co.* v. *Commissioner,* 4 T. C. 140, holding that the tax should be accrued for the year imposed and strongly relied on by counsel (Br. 41, 42), completely support our position that the tax deduction must be related to the business income it is a charge against in order to determine net income.

The numerous other cited Tax Court cases so obviously do not support taxpayer's position, or are not in point, that discussion is unwarranted.

---

[16] Although as we show, *infra*, real estate taxes are in a separate category, nevertheless, the weight of authority is that even there the lien date is irrelevant.

3. *The decision below gives effect to the Commissioner's consistent administrative practice*

The Commissioner ruled soon after the 1943 amendments to the California Bank and Corporation Franchise Tax were enacted that the tax is deductible in the taxable year. I. T. 3646, 1944–1 Cum. Bull. 104. This ruling was consistent with earlier ones dealing with previous versions of the California tax. I. T. 2770, XIII–1 Cum. Bull. 111 (1934); I. T. 2971, XV–1 Cum. Bull. 107 (1936); I. T. 2988, XV–2 Cum. Bull. 179 (1936). And, as the Tax Court accurately observed, the ruling was "consistent with the treatment accorded other state franchise taxes." (R. 59.) Illinois, I. T. 3186, 1938–1 Cum. Bull. 140; Kentucky, I. T. 3232, 1938–2 Cum. Bull. 70 Maryland, I. T. 3192, 1938–1 Cum. Bull. 144; Massachusetts, G. C. M. 22525, 1941–1 Cum. Bull. 350; Michigan, I. T. 3047, 1937–1 Cum. Bull. 66; New Jersey, I. T. 3887, 1948–2 Cum. Bull. 4; Oklahoma, I. T. 3136, 1937–2 Cum. Bull. 100; Pennsylvania, I. T. 3189, 1938–1 Cum. Bull. 141; Tennessee, I. T. 3150 and 3151, 1938–1 Cum. Bull. 125, 126. Cf. Connecticut, I. T. 2935, XIV–2 Cum. Bull. 91 (1936), and see in this connection Ellis, Deductions for Accrued Taxes, 14 Taxes, Tax Magazine 197 (1936).

In ruling in I. T. 3646, *supra,* that the 1944 California franchise tax accrues in 1944, not 1943, the Commissioner pointed out that (p. 106):

> since all the events which fix the amount of the tax and determine the corporation's liability to

> pay it have not occurred on the last day of the "income year," the tax does not accrue on that date.

As we have shown, *supra,* this test is not only the weight of authority, there is nothing to the contrary. The I. T. continues that "If it were ruled otherwise, (p. 106) the true net income * * * would not be reflected as required by sections 41 and 43 of the Internal Revenue Code."

Section 41 of the Code (Appendix, *infra*) in essence provides that net income shall be computed in accordance with the method of accounting regularly employed by the taxpayer but if the method does not clearly reflect income, the computation shall be made in accordance with "such method as in the opinion of the Commissioner does clearly reflect the income." There can be no question in view of this provision that the fact that taxpayer accrued the 1944 tax on its books for 1943 is not controlling (*Brown* v. *Helvering,* 291 U. S. 193, 203; *United States* v. *American Can Co.,* 280 U. S. 412, 419–420; *Helvering* v. *Midland Ins. Co.,* 300 U. S. 216, 223; *J. I. Case Co.* v. *United States,* 65 F. Supp. 464 (C. Cls.); *Commissioner* v. *Union Pac. R. Co.,* 86 F. 2d 637, 639 (C. C. A. 2d); *Sitterding* v. *Commissioner,* 80 F. 2d 939, 941 (C. C. A. 4th)), and it is equally clear that Section 41 delegates to the Commissioner unusual authority to determine when an item is properly accruable. The standard is proper reflection of income "in the opinion of the Commissioner." The exercise of this discretion is only reviewable when it is clearly

abused. *Lucas* v. *American Code Co., supra; United States* v. *American Can Co., supra,* 419–420. In *American Code,* for example, the Court, in approving the Commissioner's determination that it was improper to accrue a deduction for a liability for breach of contract in 1919 when the breach occurred, but that the accrual occurred in 1922 when judgment was entered against the taxpayer, stated, in referring to the prototype of Section 41 (p. 449):

> Much latitude for discretion is thus given to the administrative board [the reference is to the Bureau of Internal Revenue] charged with the duty of enforcing the Act. *Its interpretation of the statute and the practice adopted by it should not be interfered with unless clearly unlawful.* [Italics supplied.]

We have already shown that it is abundantly clear that taxpayer's accrual of the 1944 tax in 1943 does not properly reflect income. Even if there were some doubt the Bureau's consistent administrative practice under authority of a section expressly conferring wide administrative discretion is entitled to great respect.

Nor should this approach be confused with the holding in *Security Mills, supra,* as taxpayer attempts. (Br. 55.) There the Court rejected the taxpayer's argument based on Section 43 of the Code that notwithstanding when a tax legally accrues, accrual principles may be disregarded in order to give effect to a transaction, rather than yearly-accounting-period basis of reflecting income, if the latter more

clearly reflects income. Here, on the contrary, the taxpayer's method disregarded the settled rules of accrual and the Commissioner in the sound exercise of this discretion has computed taxpayer's income in a matter which clearly reflects income *and* in accordance with well settled rules of accrual.

4. *The property tax cases*

The taxpayer places substantial, if not, principal reliance on the alleged rule that real property taxes are accrued on the lien date. For this proposition it cites (Br. 26) *Magruder* v. *Supplee,* 316 U. S. 394; *California Sanitary Co.* v. *Commissioner,* 32 B. T. A. 122; *Crown Zellerbach Corp.* v. *Commissioner,* 43 B. T. A. 541.

Neither *Supplee* nor *Sanitary* is in point. The question in both was who is the taxpayer, not when does the tax accrue. This obvious and necessary distinction was accurately made not only by the court below (R. 53–54) but in two decisions not cited by counsel by the Circuit Courts of Appeals for the Third and Fifth Circuits in refusing to accept the lien dates as the point of accrual even in property taxes. *Allen* v. *Atlanta Stove Works,* 138 F. 2d 452 (C. C. A. 5th); *Commissioner* v. *Schock, Gusmer & Co.,* 137 F. 2d 750. Both decisions emphasized the controlling test of accrual we here contend for, of allocating each year's business to the appropriate portion of the accrued tax so that income is properly reflected. And both courts expressly distinguished

779450—48——3

Supplee. The Third Circuit said (p. 753) that the case was concerned with what is "taxes", not with when taxes accrue and held (p. 754) that property taxes are accruable "not for the year *in* which they were assessed [and became a lien] but for the year *for* which they were assessed." And in *Atlanta Stove* the court said that *Supplee* (p. 452) "did not deal at all with the question here involved [accrual]." See also *Citizens Hotel Co.* v. *Commissioner,* 127 F. 2d 229 (C. C. A. 5th).

It is true that *Crown Zellerbach Corp.* v. *Commissioner, supra,* reached a contrary result but a later Board case involving the accrual of property taxes distinguished such cases by saying that the lien date was not one of universal applicability, thereby limiting, if not actually repudiating, *Crown Zellerbach, S. E. & M. E. Bernheimer Co.* v. *Commissioner,* 41 B. T. A. 249, affirmed *per curiam* on authority of *United States* v. *Anderson, supra,* 121 F. 2d 454 (C. C. A. 2d).

Even if there were more persuasive authority for accruing property taxes on their lien date such decisions would not be controlling here. The Supreme Court pointed out in *Supplee* that (p. 399)—

> it is misleading to speak of real estate taxes as "applicable" to the fractional part of a tax period following purchase. * * * They are not like rent, nor are they paid for the privilege of occupying property for any given period of time.

This is to be contrasted with the California franchise tax expressly imposed for the privilege of doing business year by year and even month by month. Moreover, when a lien attaches for realty taxes a liability exists and the tax cannot be defeated. The California "lien" is imposed as we have seen before liability arises and notwithstanding that it may never arise. But the Circuit Courts of Appeals for the Third and Fifth Circuits have ignored the fixed liability in favor of giving full effect to relating the tax to the year for which imposed.

B. The time fixed in the California Franchise Act for the accrual of the tax and the attaching of the lien, both as of the last day of the income year, is not controlling for Federal tax purposes

We have already emphasized that the state accrual and lien date, as the date for accruing the subject tax, is inconsistent with well established rules of when to accrue a liability for federal tax purposes because on the state lien and accrual dates none of the events have occurred which determine liability for the tax and acceptance of that date does not relate the tax to the income of the year for which the tax is imposed. Taxpayer argues nevertheless that even if the lien date does not meet the federal test of accrual, the state accrual date governs for federal income tax purposes. (Br. 20–23.)

This argument is directly contrary to the settled principle that federal revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application. Hence their provisions are not to be

taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law. *Estate of Putnam* v. *Commissioner,* 324 U. S. 393; *Lyeth* v. *Hoey,* 305 U. S. 188, 193; *Burnet* v. *Harmel,* 287 U. S. 103, 110; *Palmer* v. *Bender,* 287 U. S. 551, 555; *United States* v. *Pelzer,* 312 U. S. 399, 402. *Estate of Putnam* also involved the question of accrual. Specifically, the question was when did declared dividends accrue to a decedent under Section 42 of the Revenue Act of 1938, c. 289, 52 Stat. 447. The Tax Court had decided the question by resorting to state law. In rejecting this approach, the Court said (pp. 395–396):

> We think the federal law controls. A federal revenue act applicable throughout the nation fixes liability on the decedent taxpayer under § 42 if the dividend is "accrued." The meaning of that word in this section should be uniform unless Congress has shown an intention to permit its meaning to be varied by state law. [Citing cases.] Section 42 lays down the test of accrual for the taxation of a decedent's income and the definition of the meaning and extent of that test is a federal responsibility. * * *

The Court in drawing a parallel between that situation and *Lyeth* v. *Hoey, supra,* said (p. 396):

> In that case an heir received a sum in settlement of litigation over a will. Its taxability as income under the federal statute depended upon the meaning of the statutory exemption "acquired by inheritance." The law of the

> testator's domicile held sums paid as will compromises were not inheritances. Acting on the principle that, in the interest of uniformity, exemptions under federal statutes should be determined by federal courts, we reached a contrary federal rule. The same principle leads to our conclusion in this case.

There is nothing in *Commissioner* v. *Le Roy,* 152 F. 2d 936 (C. C. A. 2d), relied on by counsel (Br. 21–23) to the contrary. The question there as in *Magruder* v. *Supplee, supra,* was whether the taxpayer-purchaser could deduct property taxes he paid but which were assessed prior to his purchase. The court stated (p. 937) "what are taxes and who is the taxpayer depends upon local law." Here, there is no question that Central Investment Corporation is the taxpayer and that California franchise taxes are taxes. When those taxes should be accrued is exclusively a federal question.

George S. Colton Elastic Web Co. v. *United States, supra* (p. 204), is closely in point. There the Circuit Court of Appeals in determining when the Massachusetts excise tax measured both by net income and "corporate excess" accrues refused to be bound by the decision of the Supreme Judicial Court of Massachusetts that the tax was "single". Whether it was or not for the purpose of determining when the tax accrued for federal incomes taxes was a federal question.

In addition to the cases cited under this subheading, all the accural cases cited under sub-heading

"A", *supra,* show that the only relevance of state law is to determine (1) when *all* the events creating liability occur and (2) the period for which the tax is imposed. Giving full effect to California law for these purposes, the tax accrued in 1944.

C. The scope of the Court's review of this issue is restricted by the "Dobson" principle

We conclude our argument where taxpayer started his (Br. 10–12) with a discussion of *Dobson* v. *Commissioner,* 320 U. S. 489. We have not emphasized *Dobson,* not because of non-applicability but because this is not a close case. Rather it is one where if the Tax Court had reached any other result reversal would have been required and in that sense it is superfluous to apply a principle designed to give the Tax Court finality where there is a possibility of two reasonable results. However, if the Court should think that taxpayer's position has some support, the *Dobson* concept must prevail to defeat it. In this connection it must also be noted that taxpayer is met with the firmly entrenched doctrine that deductions are not matters of right but of legislative grace to be strictly construed.[17] This places a further burden in the path of their construction. Moreover, in light of the administrative discretion delegated to the Commissioner by Section 41 of the Code in this type of case as emphasized, *supra,* the Commissioner, not the Tax Court, is entitled to finality barring abuse of dis-

[17] *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, 593, and cases cited; *White* v. *United States*, 305 U. S. 281, 292; *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, 106.

cretion. Here then are operative alternative theories of finality of the result below.

The question here presented is obviously of an accounting nature which the Supreme Court expressly placed within the category of cases not giving rise to a clear-cut question of law in which the decision of the Tax Court is entitled to finality. *Dobson* v. *Commissioner, supra,* pp. 501–502;[18] cf. *Seattle Brewing & Malting Co.* v. *Commissioner* and *Commissioner* v. *Ranier Brewing Co.,* both decided by this Court January 8, 1948, and petitions for rehearing in both denied in an opinion entered February 18, 1948.

Dobson was decided on December 20, 1943. On January 3, 1944, the Court decided *Dixie Pine Co.* v. *Commissioner, supra.* That case involved the question we have here—namely, in what year should a state tax liability be accrued. A unanimous Court there said (p. 519):

> To this effect are the decisions of the Board of Tax Appeals in numerous cases, and the instant decision was in line with earlier rulings as to proper tax accounting practice. Since the Board applied the correct rule of law, its determination that the item in question was not properly deducted on the accrual basis is entitled to the finality indicated by *Dobson* v. *Helvering, ante,* p. 489. The court below prop-

---

[18] The Court there said:

"Whatever latitude exists in resolving questions such as those of proper accounting, * * * exists in the Tax Court and not in the regular courts; when the court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand."

erly refused to disturb the Board's determination.

Security Mills Co. v. *Commissioner, supra,* was decided in the next month, on February 28, 1944. As we have pointed out, *supra,* that case involved the precise question as *Dixie Pine, except* that the taxpayer in effect, conceding that the contested tax had not accrued in the year deducted, urged the applicability of Section 43 to circumvent the accrual principles. The Tax Court applied Section 43 and this determination the Court characterized thus (p. 286)—"as matter of law, the Board misconstrued the extent of the power conferred by the Revenue Act." The question, the Court emphasized (p. 286) "is not whether the Board, within its discretion, made a determination of fact." But Section 43 was not relied on by the Tax Court here in derrogation of accrual principles. Taxpayer's reliance on *Security Mills* is then obviously misplaced and moreover attributes to the Supreme Court a repudiation *sub siliento* of a unanimous opinion rendered only eight weeks before.

CONCLUSION

The Tax Court was correct. It should be affirmed.

Respectfully submitted.

Theron Lamar Caudle,
Assistant Attorney General.
Sewall Key,
A. F. Prescott,
Irving I. Axelrad,
Special Assistants to the Attorney General.

March 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [as amended by Section 202 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year,

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

Part IV—Accounting Periods and Methods of Accounting

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1940 ed., Sec. 41.)

Sec. 43. Period for which deductions and credits taken.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 1940 ed., Sec. 43.)

Sec. 48. Definitions.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued".*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1940 ed., Sec. 48.)

California Bank and Corporation Franchise Tax Act (3 Deering, California General Laws, 1945 Pocket Supp., Act 8488):

§ 4. *Corporations subject to tax: Tax measurement and computation: Offsets: Exempt corporations.*

* * * * *

(3) [*Other corporations doing business in State: Measurement and computation of tax: Minimum.*]—With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions of the Constitution of this State or by this act,

shall annually pay to the State, for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars ($25).

* * * * *

(5) [*Corporations not otherwise taxed: Amount of tax.*]—Every corporation not otherwise taxed in pursuance of this section and not expressly exempted by the provisions of this act or the Constitution of this State shall pay annually to the State a tax of twenty-five dollars ($25).

* * * * *

(7) [*When taxes accrue.*]—Taxes under this section and under Sections 1 and 2 of this act shall accrue on the last day of the "income year," as defined in Section 11 hereof.

* * * * *

§ 11. *Definitions.*—(a) The term *"income year,"* as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein. "Income year" means, in the case of a return made for a fractional part of a year, the period for which such return is made.

(b) The term *"taxable year,"* as herein used, means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. A "taxable year" may constitute a period of 12 months or of less duration.

* * * * *

(d) The terms *"paid or incurred"* and *"paid or accrued"* shall be construed according to the

method of accounting upon the basis of which the net income is computed hereunder.

*   *   *   *   *

§ 13. *Returns: Prepayment of taxes, etc.*

(a) [*Returns.*]—Every bank and corporation subject to the tax imposed by this act shall, within two months and 15 days after the close of its income year, transmit to the commissioner a return in a form prescribed by him, specifying, for the income year, all such facts as he may rule, or otherwise, require in order to carry out the provisions of this act. * * *

*   *   *   *   *

(b) [*Prepayment of minimum taxes.*]—A corporation which incorporates or organizes under the laws of this State or qualifies to do business in this State, after the effective date of this act, shall thereupon prepay the minimum tax hereunder, which prepayment must be made before the corporation files with the Secretary of State its articles of incorporation or duly certified copy thereof as the case may be.

*   *   *   *   *

(k) [*Dissolved or withdrawn banks or corporations.*]—(1) Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any taxable year shall pay a tax hereunder only for the months of such taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by (A) the net income of the preceding income year or (B) a percentage of such net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of such income year, whichever is the lesser amount; * * * In any event, each such corporation shall pay a tax not subject to offset for such period in an amount

equal to the minimum tax provided for in Section 4 of this act.

*   *   *   *   *

§ 23. *Time for payment of taxes: Extension of time: Payment to commissioner: Deposit of moneys received.* * * *

*   *   *   *   *

In the case of corporations of the classes referred to in Subdivision (3) of Section 4 of this act, one-half the amount of tax disclosed by the return shall be due and payable as a first installment of the tax on such corporations on or before the fifteenth day of the third month following the close of the income year, as defined in Section 11 hereof. The balance of the tax shall be due and payable as a second installment on or before the fifteenth day of the ninth month following the close of the income year. A tax imposed by this act or any installment thereof may be paid at the election of the taxpayer, prior to the date prescribed for its payment.

*   *   *   *   *

§ 29. *Tax lien: Certificate of satisfaction.*

[*Taxes constitute lien: Effect, etc.*]—The taxes imposed by this act and disclosed on the return shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the last day of the "income year," * * *. The taxes imposed by this act and determined pursuant to Sections 16, 25 or 28 shall constitute a lien upon all real property of the taxpayer located in any county in which there is filed for record in the office of the county recorder a certificate executed by the commissioner stating that payment of a tax determined under the provisions of Sections 16, 25 or 28 of this act has been demanded and has not been paid and specifying the amount

thereof and the name of the taxpayer, and such lien shall attach at the time the certificate is recorded and shall have the same force, effect and priority as a judgment lien. The lien provided for in this section shall remain until the taxes are paid or the property subject to the lien is sold for the payment thereof, or until the lien is released or otherwise extinguished. * * *

*   *   *   *   *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23 (c)–1. (a) *In general.*—Subject to the exceptions stated in this section and sections 29.23 (c)–2 and 29.23 (c)–3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). * * *

Sec. 29.41–1. *Computation of net income.*— * * * The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42–1 to 29.42–3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41–2. *Bases of computation and changes in accounting methods.*—Approved standard methods of accounting will ordinarily

be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

SEC. 29.41–3. *Methods of accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. * * *

SEC. 29.43–1. *"Paid or incurred" and "paid or accrued."*—(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. * * *

SEC. 29.43–2. *When charges deductible.*—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of

one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1948